

Final Analysis: The 2005 Budget

**July 21, 2005
SENATE REPUBLICAN
FISCAL OFFICE**



Table of Contents

EXECUTIVE SUMMARY.....1

EDUCATION2

HIGHER EDUCATION.....4

HEALTH.....5

HUMAN SERVICES11

TRANSPORTATION13

RESOURCES, ENVIRONMENT AND ENERGY16

PUBLIC SAFETY AND JUDICIARY.....21

GENERAL GOVERNMENT25

LOCAL GOVERNMENT28

SENATE REPUBLICAN FISCAL STAFF ASSIGNMENTS.....30

Executive Summary

(Dollars in Thousands)

Fund	Governor's Budget As Revised	Legislative Changes	Vetoed	Budget Totals
General Fund	\$88,525,293	\$1,645,612	-\$144,945	\$90,025,960
Special Funds	23,115,351	290,773	-74,287	23,331,837
Bond Funds	4,097,530	-93,795	-16	4,003,719
Federal Funds	55,938,036	390,303	-122,010	56,206,328
Total State Funds:	\$115,738,174	\$1,842,590	-\$219,248	\$117,361,516
Total Budget	\$171,676,209	\$2,232,893	-\$341,258	\$173,567,844

The Budget Act of 2005 (SB 77, Chapter 38, as amended by SB 80, Chapter 39) authorizes total state spending of \$117.4 billion. (This total excludes \$56.2 billion in federal funds.) This total is nearly identical to revised total expenditures for 2004. However, the 2005 Budget spends less bond funds (reflecting the billions of dollars in school bond funds transferred to schools in 2004), while increasing General Fund expenditures \$8.3 billion beyond the total for 2004. The net result is a 10.2 percent year-over-year increase in General Fund expenditures when compared to the revised figures for 2004, and a 14.3 percent increase over General Fund expenditures originally authorized in the 2004 Budget Act. (As a point of comparison, General Fund revenues are only expected to grow at a rate of 5.7 percent between 2004 and 2005.) While the increase in General Fund expenditures is considerable, several billion dollars of this growth is either one-time in nature, or is the result of revenue and savings assumptions that were unrealized as part of the 2004 Budget.

The 2005 Budget is a considerable improvement over the 2004 Budget. It contains a number of important investments, including \$1.3 billion in Proposition 42 transportation funds, and over \$3 billion in additional funding for education, \$30 million of which will provide additional community college equalization funds. The Budget also temporarily suspends cost of living adjustments (COLAs) in some entitlement programs, reducing the amount of programmatic growth that would otherwise occur and that would further exacerbate out-year funding pressures.

The Budget Does Not Raise Taxes or Rely Upon Economic Recovery Bonds (ERBs).

The Budget prudently utilizes one-time revenue to prepay cities and counties the \$1.2 billion they lost between July and October of 2003, when the Vehicle License Fee offset program was temporarily suspended by then Governor Davis. This funding was originally scheduled for repayment in 2006-07. Additionally, while the initial Governor's Budget proposed to use \$1.7 billion of \$3.7 billion in available ERB funds to close the gap between revenues and expenditures, the final Budget instead relies on improvements in one-time revenues in lieu of ERB funds, thereby retaining the existing \$3.7 billion in ERB capacity for future needs.

The Need for Reform Continues. Despite the improvements mentioned above, the Budget still contains structural impediments that will likely push expenditures beyond the rate of General Fund growth. Indeed, the Budget will spend \$5.8 billion more than it takes in, and is only in balance as a result of considerable one-time prior-year carryover funds. Many of the

expenditure pressures that drive significant increases in autopilot spending are still in place, and will likely push existing expenditures beyond what is currently estimated by billions of dollars.

Some of this growth could occur even before the Governor submits his proposed budget for 2006. As an example, the Budget Act of 2004 authorized \$78.7 billion in General Fund expenditures. However, the revised estimate of General Fund expenditures for 2004 at the signing of the 2005 Budget Act was \$81.7 billion—a \$3 billion increase. The difference between General Fund expenditures authorized in the 2003 Budget Act and the revised General Fund expenditures for that year was even worse: \$7.2 billion. These increases contribute to the ever-expanding growth in state General Fund spending, and without meaningful structural reform, or a major increase in state revenues, the state will continue to spend more each year than it takes in, resulting in additional pressure to raise taxes.

Education

Funding for Education Continues to Rise. The Budget provides about \$50 billion in Proposition 98 funding for K-12 schools and community colleges, up by about \$3 billion (over six percent) over last year, while growth in the number of K-12 students is expected to rise by less than one percent. Total K-12 funding from all sources will reach almost \$62.3 billion, and annual per-pupil funding from all sources will for the first time exceed \$10,000 (see chart below).

Proposition 98 Overappropriated. The Budget provides the same \$50 billion proposed by the Governor in his January budget proposal. At that time, the proposed appropriation was equal to the minimum Proposition 98 guarantee. However, because the guarantee has since fallen, the budgeted appropriation is now about \$741 million over the minimum. This overappropriation will reduce the state's "maintenance factor" obligation, which at the end of 2005-06 is expected to total about \$3.8 billion, mostly due to the 2004-05 suspension of the guarantee.

Proposition 98 Funding

Appropriations (Dollars in thousands)	General Fund		Local Property Taxes		Total	
	2004-05	2005-06	2004-05	2005-06	2004-05	2005-06
K-12 schools	\$30,877,059	\$33,070,754	\$11,193,389	\$11,573,102	\$42,070,448	\$44,643,856
Community Colleges	\$3,036,320	\$3,413,274	\$1,738,654	\$1,803,685	\$4,774,974	\$5,216,959
Other	\$95,910	\$106,805	\$0	\$0	\$95,910	\$106,805
	<u>\$34,009,289</u>	<u>\$36,590,833</u>	<u>\$12,932,043</u>	<u>\$13,376,787</u>	<u>\$46,941,332</u>	<u>\$49,967,620</u>
Minimum guarantee (if no suspension)					\$50,768,634	\$49,226,734
Suspension/overappropriation					-\$3,827,302	\$740,886
Per-pupil expenditures (in whole dollars):						
Proposition 98 only					\$7,023	\$7,402
All fund sources (federal, lottery, etc)					\$9,945	\$10,325
Proposition 98 "split" (CCC percentage)					10.19%	10.46%

Growth and COLA Provide \$1.8 Billion in Discretionary Funding. The Budget provides full funding for anticipated K-12 growth (0.69%) and COLA (4.23%), as the Governor proposed. These unrestricted funds may be used by school districts for whatever purpose they deem necessary or desirable.

Current Mandate Payments Deferred; Old Mandate Debt Partially Repaid. Payments for 2005-06 mandated activities (about \$300 million) will continue to be deferred; however, the Budget does include \$60.6 million in one-time funds to pay down the state's obligation for prior year activities.

Special Education. The Budget provides the same level of support for special education that the Governor proposed, but reallocates the funding in a number of ways. Some of the more notable features of this year's special education budget are:

- **New Growth/COLA Formula.** The Budget revises the special education funding formula so that, effective in 2005-06, the General Fund will cease to provide growth and COLA for the federal piece of the special education budget, and all federal fund augmentations will be passed through to local educational agencies. (In past years, the state has provided growth and COLA on the entire special education budget, including the federal piece, but has used federal funds to offset some General Fund expenditures). No savings are achieved in 2005-06, but in future years, this action is expected to result in General Fund savings.
- **Family Empowerment Centers.** The Budget provides an additional \$420,000 in federal funding for centers in new areas of the state, bringing total funding to about \$2.8 million.
- **Mental Health Services.** The Budget continues to include \$100 million for mental health programs for special education children: \$69 million for AB 3632 services provided by counties and \$31 million for pre-referral services provided by local educational agencies.

High Speed Network Appropriation Eliminated. The Legislature eliminated funding for the K-12 high speed network (\$21 million) and instead authorized use of previously appropriated but unspent funds for this purpose, pending an audit of the network. The extent to which these unspent funds are actually available, and to which the network will be able to continue operation without them, is unclear.

Teachers' Pension Shift Denied. The Legislature denied the Governor's proposal to withdraw about \$470 million in state contributions toward teachers' retirements and instead require that school districts either fund that cost directly or negotiate with employee unions to assume it.

Governor's Child Care Reforms Denied. Both houses of the Legislature rejected the Governor's proposed reforms to the state's subsidized child care programs and the associated annual savings of about \$168 million. However, the Budget does include \$7.9 million proposed by the Governor to establish county-wide eligibility (waiting) lists for state-subsidized child care.

Enhanced Local Flexibility Denied. The Legislature denied the Governor's proposal to expand local authority to shift funding between categorical programs. The 2004-05 limits that

applied to the programs listed in Control Section 12.40 and the block grants created by last year's AB 825 were not relaxed.

Governor's Initiatives Denied. The Budget denies most of the Governor's proposed initiatives, most notably including:

- \$52.4 million to expand class size reduction by one grade for decile 1-3 schools (those whose students' test results are the lowest)
- \$30 million to expand the Beginning Teacher Support and Assessment (BTSA) to teachers beyond their first and second years.
- \$30 million to establish a pilot career technical (vocational ed) program to allow career exploration coursework in the 7th and 8th grades.
- \$1.6 million to encourage high schools to establish smaller learning environments ("schools within a school")
- \$500,000 to reimburse the state's 50,000 high school coaches for training on the identification, risks, and effect of performance enhancing drugs.

K-12 Vetoes. The Governor vetoed a number of K-12 appropriations, most notably including:

- \$74.5 million in federal carryover funds, which he set aside for appropriation to support Program Improvement schools (those failing to meet federal standards).
- \$20 million in funding for supplemental instructional materials for English language learners, which the Legislature had attempted to make veto-proof by tying the funds to the Governor's vocational education initiative. The Governor vetoed funding for both programs, and set it aside for subsequent appropriation.
- \$2 million for new Healthy Start grants, which the Governor set aside for restoration in a manner that will ensure no future cost or cost pressure.

Higher Education

Community College Funding Grows. The CCCs' total revenue from all sources will grow by almost half a billion dollars, exceeding \$8 billion in 2005-06. The Budget provides a 4.23% COLA, 3% for enrollment growth, \$30 million for equalization of revenue limit funding, and \$10 million to expand nursing programs. The colleges' share of 2005-06 Proposition 98 funding will rise to 10.46%, up from 10.19% in 2004-05. Student fees will remain unchanged at \$26 per unit, still the lowest in the nation.

Compact with University of California and California State University Continues. The UC and CSU budgets are generally consistent with the compact negotiated between the Governor and the segments in 2004-05 that focused on predictability, both in terms of student fees and funding increases for the institutions.

- Institutional funding increases (COLA) of 3% and enrollment growth funding of 2.5% are provided to both UC and CSU.

- The UC Regents and CSU Trustees both adopted student fee increases for 2005-06 several months ago. The Budget recognizes the adopted fee levels. System-wide undergraduate fees will be about \$6,150 at UC and \$3,100 at CSU.
- \$1 million (\$750,000 at UC and \$250,000 at CSU) is provided for an initiative to increase the number of math and science teachers trained by the universities.

Outside of the compact, the Legislature restored outreach-related funding of \$17.3 million at UC and \$7 million at CSU, which had been appropriated on a one-time basis in 2004-05. The Governor *did not veto* these funds.

Higher Education Vetoes. The Governor vetoed a number of appropriations for higher education, most notably including:

- \$20 million for his own vocational education initiative, which the Budget had made contingent on funding for an unrelated K-12 program. Citing violation of his constitutional veto authority, the Governor set these funds aside for restoration through separate legislation.
- \$17.4 million (reduced from \$33 million to \$15.6 million) for backfill of lower-than-expected Community College local property tax revenue. The Governor set these funds aside for appropriation through separate legislation to expand vocational education.
- \$3.8 million for the UC Labor Institute.
- \$3.44 million (reduced from \$4 million to \$560,000) for a CSU program to increase slots for entry-level masters program nurses who will eventually become nursing faculty. The Governor set the funds aside for restoration through separate legislation to address nursing shortages.

Funding for Student Financial Aid Rises.

- The Budget provides full funding for the Student Aid Commissions' estimate for 05-06 Cal Grant awards. Total Cal Grant funding will rise to almost \$775 million.
- \$51 million in one-time General Fund savings are created by using excess reserves in the Student Loan Operating Fund (SLOF) to offset General Fund expenditures for Cal Grants by an identical amount.
- The maximum Cal Grant award for private universities continues unchanged at \$8,322 per year.

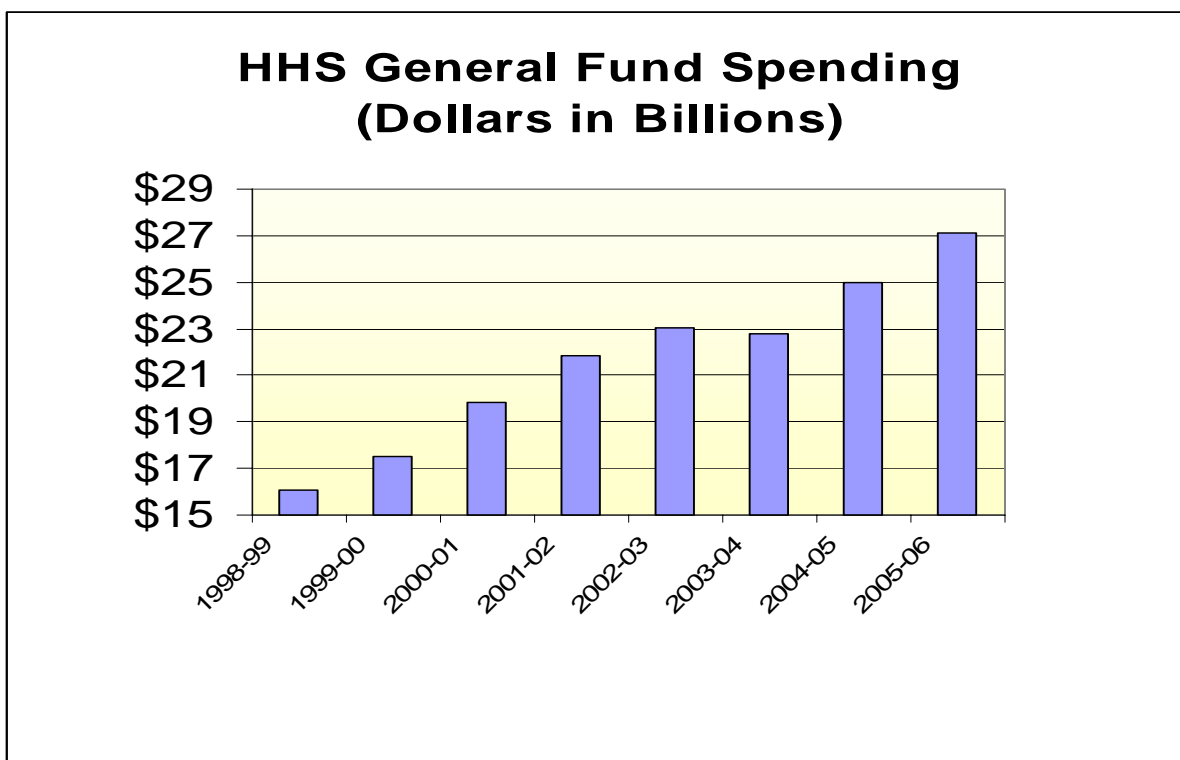
Health

For the 2005-06 fiscal year, the Budget proposes total expenditures of \$71.9 billion from all fund sources, including federal funds, for all Health and Human Services Agency budgets. General Fund expenditures for Health and Human Services are projected to be \$27.1 billion, which represents *an increase of over \$2.1 billion General Fund* (or 8.5 percent) as compared to the revised 2004-05 expenditure level. The Budget predominantly reflects Democrat priorities for spending in the Health program area. It provides no meaningful reductions or spending cuts for health programs, and virtually all of the General Fund spending reductions

are derived from enhanced federal funds, accounting changes, fund shifts, and savings assumptions that will likely not materialize.

As this budget continues to expand and augment state spending for health programs, it also reflects actions by the Majority to reject important Medi-Cal Restructure proposals that *would have reduced spending by \$145 million General Fund* over the next five years. A new study by the Public Policy Institute of California (PPIC) projects that, absent any policy changes, Medi-Cal benefit expenditures will grow from the current \$13 billion General Fund to \$29.1 billion by 2015.

The Medi-Cal program is the second largest General Fund expenditure after K-12 education. However, unlike education, much of the spending for Health and Human Services is discretionary. Health and Human Services includes many large, complex, and costly programs that affect the lives of millions of Californians. The long-term restructuring necessary to reduce the ever-increasing General Fund cost of these programs will take a great deal of sensitivity and effort. Any meaningful reforms will take multiple years to implement and; therefore, must begin immediately in order to address California's fiscal crisis. Unfortunately, the "solutions" contained in the Budget fail to address the structural deficit, and runaway spending for health and human services is continued.



Department of Health Services

Medi-Cal

Medi-Cal serves one in six Californians. The Budget includes \$34.6 billion (\$13 billion General Fund) to fund the Medi-Cal Program, which represents an increase of nearly \$1.3 billion General Fund (or 10.8 percent) above the revised 2004-05 level.

A new PPIC study projects that Medi-Cal benefit expenditures will grow by about 8.5 percent annually over the next ten years. In 2010, the forecasts indicate that the total cost of the Medi-Cal program will rise to \$53.9 billion, \$19.7 billion of which would be paid by the state. By 2015, these totals will rise further to \$79.6 billion, with \$29.1 billion out of the General Fund (more than the combined cost of all Health and Human Services programs today). Overall population growth accounts for only about 17 percent of the projected increase in benefit expenditures.

At 8.5 percent, the average growth in Medi-Cal expenditures will outpace the expected 6 percent annual growth in state revenues projected by the Legislative Analyst's Office. Accordingly, Medi-Cal can be expected to absorb a growing share of the overall General Fund budget, rising from 15 percent in 2003 to 19 percent in 2010 and 21 percent in 2015. *In 2010, forecasts indicate that Medi-Cal will require an additional \$3.7 billion over and above the costs expected if Medi-Cal expenditures remained a constant share of state revenues.*

Major Medi-Cal Budget Issues Include:

Rejects Medi-Cal Redesign. The Budget *does not include* most of the Governor's Medi-Cal Redesign proposal. Specifically, the Governor's proposal to require certain Medi-Cal enrollees to pay premiums was rejected, the Administration's changes to allow a private vendor to process Medi-Cal eligibility (i.e., Single Point of Entry) was rejected, and most importantly the mandatory enrollment of aged, blind and disabled that would have provided 90 percent of the savings associated with the Medi-Cal managed Care expansion was rejected.

Medi-Cal Managed Care Expansion. While rejecting the mandatory enrollment of aged, blind and disabled beneficiaries, the Budget does provide \$2.2 million General Fund for expansion into 13 new counties using the existing program enrollment method of mandatory enrollment for children and families, and the voluntary enrollment of the aged, blind and disabled; and it allows for existing County Organized Health Care Systems (COHS) to expand into additional counties. COHS require the mandatory enrollment of aged, blind, and disabled individuals.

New Presumptive Eligibility Program. The Budget includes an additional \$1.2 million General Fund augmentation to fund partial year implementation of yet another Democrat program expansion that provides full scope Medi-Cal benefits to children that are not eligible for that level of benefits. The program provides "accelerated enrollment" for certain children who have a high share-of-cost in Medi-Cal. These children will receive unlimited free Medi-Cal coverage pending enrollment into the Healthy Families Program.

Hospital Financing Waiver. The Budget contains no modifications associated with the Administration's proposed Hospital Financing Waiver even though California's existing Waiver expired June 30, 2005. The federal government has approved a one month extension to July 31, 2005. It appears this issue, which involves about \$2 billion for California's safety net hospitals, will be addressed in separate legislation before the end of session.

Medi-Cal Funded Induced Abortions. The Budget includes about \$35 million General Fund to pay for abortion services.

Federal Funds for Prenatal Care. The Budget assumes a \$191.7 million General Fund savings from authorizing the Department of Health Services (DHS) and Managed Risk Medical Insurance Board (MRMIB) to submit a State Plan Amendment (SPA) to the federal CMS in

order to draw down a 65 percent federal match for the state's Prenatal Care Program for Pregnant Undocumented Women in Medi-Cal and the Access for Infants and Mothers (AIM) Program.

Modified Denti-Cal Adult Dental Cap. The Budget includes an augmentation of \$19 million General Fund because the Democrats adopted an expenditure cap for Adult Dental services provided to Medi-Cal enrollees that differs significantly from the \$1,000 annual cap proposed by the Governor and effectively eliminates any savings in the 2005-06 budget. Additionally, the modifications reduce the potential annual savings in future years by over \$16 million General Fund (from about \$19 million to about \$3 million). This modified cap has a set limit of \$1,800 over a calendar year, and commences as of January 1, 2006. The cap excludes a variety of services (e.g., emergency services, dentures, dental services provided in a long-term care nursing home setting, and complex oral and maxillofacial surgeries).

Long-Term Care Rate Increases. The Budget provides \$29.9 million General Fund to provide rate increases to various long-term care facilities that do not receive increases via the nursing home quality improvement fee (i.e., AB 1629, Statutes of 2004).

Nursing Home Quality Improvement Fee. The Budget includes \$421 million General Fund to provide a cost-of-living-adjustment (COLA) and rate increase to certain nursing homes pursuant to AB 1629, Statutes of 2004. AB 1629 provides for the establishment of a facility specific rate methodology by August 1, 2005, and institutes a quality improvement fee to be effective August 1, 2004. As a result of implementing this new fee the cost of the COLA and rate increase is offset by about \$361 million of new revenue to the General Fund.

New Exemptions for Adult Day Health Care (ADHC). The Budget reflects an augmentation of \$11.2 million General Fund for ADHC providers because the Majority (1) changed the existing moratorium to address specific needs of ADHC providers in their districts (San Francisco, Napa, Humboldt, and Imperial Counties), and (2) rejected the Administration's proposal to freeze ADHC provider rates (instead a 5.8 percent rate increase is provided).

Speculative Drug Rebate Savings. The Budget assumes a reduction of \$3.5 million General Fund that was adopted by the Majority to reflect a January 1, 2006 implementation date for obtaining federal government approval of the Department of Health Services' request regarding the states Medi-Cal Drug Rebate Program (i.e., "protecting rebates"). It is unlikely that these savings will materialize

Additional Dent-Cal Provider Enrollment Staff. The Budget provides \$121,000 General Fund for three additional positions at Delta Dental to process the enrollment of dentists into the Medi-Cal Program (Denti-Cal).

Cal-Optima Medi-Cal Managed Care Rate Increase. The Budget includes \$9.2 million General Fund to provide a 3 percent rate increase to CalOPTIMA, the County Organized Health Care Systems of Orange County. This rate increase was proposed by the Administration.

Medicare Part D. The Budget still includes the Administration's Medicare Part D adjustments:

- **"Clawback"** - A one-time reduction of \$135.6 million as a result of a federal decision to delay states payment of the "clawback" (February 2006 instead of January 2006).
- **Medicare Part D Excluded Drug Coverage** - An increase of \$46.8 million to provide coverage of "excluded drugs", which are drugs that are currently covered by Medi-Cal that will not be covered by Medicare Part D.

- **Medicare Part D Managed Care Savings** – A decrease of \$57.6 million to reflect savings associated with lower managed care capitation payments to Medi-Cal Managed Care plans since dual eligibles (i.e., persons eligible for both Medicare and Medi-Cal) will now receive drugs through Medicare.

Public Health Programs

West Nile Virus. The Budget provides \$12 million General Fund to assist in mitigating the spread of West Nile Virus. Of this amount, \$10 million will be allocated to local vector control districts for mosquito mitigation in high priority areas of the state and “hot spots” based on epidemiological studies.

Governor’s Obesity Initiative Rejected. The Budget includes only \$180,000 General Fund for one Medical officer position to coordinate existing programs and functions. The Governor had requested \$6 million for a variety of state operations and local assistance efforts to fill existing gaps, and to enhance existing efforts.

California Rx Program Rejected. The Budget reflects the elimination of \$11.7 million General Fund associated with the implementation of the Governor’s California Rx Program.

Continued Suspension of General Fund for County Health Programs. The Budget assumes that the state share-of-cost for the County Medical Services Program (CMSP) is suspended for another year. The state General Fund contribution has been suspended every fiscal year since 1999-2000. Current law places the state at risk for any cost that exceeds the cumulative annual growth in dedicated sales tax and vehicle license fee revenue, up to a maximum of \$20,237,460 per fiscal year.

Genetic Disease Testing Program. The Budget includes \$15 million Genetic Disease Testing Fund to expand the Newborn Screening Program. This was approved despite concerns raised by Republican Members about the ability of DHS to implement this program expansion in a cost effective and timely manner.

Managed Risk Medical Insurance Board

Healthy Families Program

Caseload. The Budget fully funds expenditures for the Healthy Families Program (HFP), which is projected to be \$959.3 million (\$347.4 million General Fund). The Administration estimates that enrollment will grow from 740,835 by year-end 2004-05 to 867,418 in 2005-06 for a total increase of 126,583 children. No new cost controls are adopted for HFP this year. To the contrary, the Budget provides a rate increase for health plans and re-establishes an outreach program to increase enrollment that had been eliminated several years ago to reduce costs (see below).

Rate Increase. The Budget includes \$5.1 million to provide an average 1.6 percent rate increase to HFP health plans. The HFP had a rate freeze in place for the past two years pursuant to the 2003 Omnibus Health Budget Trailer Bill (AB 1762).

HFP/Medi-Cal Application Assistance Funding. The Budget provides \$5.9 million General Fund to re-establish the Certified Application Assistance (CAA) program that provides payment of \$50 for a new application and \$25 for an annual eligibility review to individuals and

organizations that help potential eligibles fill out the application forms. Both advocates and the Managed Risk Medical Insurance Board have cited the lack of outreach and application assistance funding as the primary reason enrollment in HFP as leveled off. However, there are no studies that support the efficacy of past outreach efforts.

Access for Infants and Mothers (AIM) Fund Shift. The Budget reflects a fund shift in the AIM program from General Fund support to the use of Proposition 99 funds as proposed by the Administration. This fund shift results in a net savings of \$27.4 million (General Fund) after accounting for new and increased spending in other program areas. This action assumes the receipt of federal S-CHIP funds as a match to the Proposition 99 funds. Senate Bill 88, which recently passed on a four-fifths vote of the Legislature, amended Proposition 99 to allow for Proposition 99 funds to be used to match federal funds.

Managed Risk Medical Insurance Program (MRMIP). The Budget includes \$40 million (Proposition 99 funds) to fund the MRMIP at its historic levels.

Department of Developmental Services

Continues Existing Cost Containment Measures. The Budget reflects savings of \$84.3 million General Fund related to the continuation of existing cost containment measures on the purchase of services expenditures which have been in effect since the Budget Act of 2003. This includes all of the rate freezes, the extended assessment timeframe (increased from 60 days to 120 days), as well as the revision to eligibility, the Family Cost Participation Program, and the unallocated reductions.

Rejects Additional Cost Containment Measures. The Budget includes a net \$4.2 million General Fund augmentation as a result of the rejection of a variety of “common sense” cost containment strategies that would have resulted in nearly \$63 million of General Fund savings over a three year period on the purchase of services expenditures.

Increased Funding for Regional Center Staffing. The Budget provides \$4 million General Fund for the Regional Center’s operations budget to hire 103 Service Coordinators, 9 Physicians, and 13 Psychologists to help Regional Centers maintain compliance with the federal CMS regarding the Home and Community-Based Waiver. This amount is in lieu of the \$8.8 million General Fund initially requested by the Administration.

Continues Costly Agnews Community Placement Plan. The Budget includes \$12.6 million General Fund to continue implementation of an extremely costly community placement plan that, as proposed by the Administration, *could cost in excess of \$300,000 per client*. The Administration has not been able to justify the extraordinary costs associated with these new community residential facilities.

Supported Employment Program. The Budget includes an augmentation of \$1.1 million General Fund in the Department of Developmental Services, and \$459,000 General Fund in the Department of Rehabilitation to return the Supported Employment Program group size back to a ratio of three individuals per counselor (1:3), versus its present size of four individuals per counselor (1:4).

Department of Mental Health

Rejects Repeal of AB 3632 Mandate. The Budget includes \$120 million General Fund to provide reimbursement of county mandate claims for costs incurred by County Mental Health Departments in providing services related to the AB 3632 mandate. This level of funding provides \$60 million for 2004-05 claims and \$60 million for 2005-06 claims. The LAO has indicated that the funding provided will likely be inadequate. Federal law (the Individuals with Disabilities Education Act) requires states to guarantee disabled students the right to receive a free and appropriate public education that emphasizes special education and related services, which may include mental health services. AB 3632 shifted this responsibility from schools to counties thus creating a local mandate. Democrats *rejected the Administration's proposal to repeal sections of Government Code that create the mandate* on the counties. An additional \$100 million of special education funding is included in the Department of Education budget for AB 3632 services.

Restructure Sexually Violent Predator (SVP) Program. The Budget reflects a savings of \$6 million General Fund by restructuring the SVP Treatment Program to only provide treatment in State Mental Hospitals to those who want to participate. Those who opt out of treatment will continue to be housed in the State Mental Hospital in a secure setting.

Chronic Homelessness Initiative. The Budget includes a proposal that utilizes \$2.4 million of Proposition 63 (Mental Health Services Act) funds for collaboration between the Health and Human Services Agency, and the Business, Transportation and Housing Agency. These funds are available for two years and will be used *primarily for rent subsidies*. In addition, \$40 million is redirected from existing housing bonds and \$10 million from the California Housing Finance Agency to create 400-500 units of permanent housing with services for the mentally ill.

Mental Health Services Act (Proposition 63). The Budget includes \$16.6 million from the Mental Health services Fund and nearly 90 new state staff for the Department of Mental Health to implement Proposition 63.

Human Services

CalWORKs

The 2005 Budget provides \$6.8 billion total funds for California Work Opportunity and Responsibility to Kids (CalWORKs) programs. Caseload is expected to be 487,000 in 2005-06, down 1.1 percent from the 2004-05 caseload projection of 492,000.

Restorations. The Budget rejects the Governor's proposals to reduce CalWORKs grants by 6.5 percent and reform taxpayer-supported child care. These proposals would have reduced expenditures by \$166 million and \$123.8 million respectively and would have gone a long way in addressing the General Fund deficit the state will still be facing in 2006-07.

Suspension of Grant COLAs. The Budget reflects \$135.5 million in General Fund savings from the suspension of the July 2005 CalWORKs grant cost-of-living adjustment (COLA). The Budget also suspends the July 2006 CalWORKs COLA, for estimated additional savings of

\$138.8 million General Fund in 2006-07. The suspension of the CalWORKs grant COLA will help to address the structural deficit between revenues and expenditures, and even with the COLA suspension, California's grant levels remain among the highest in the nation.

Work Reform. The Budget reflects CalWORKs grant savings of \$22 million from the implementation of an incentive program that rewards counties that meet specific program outcomes. The Budget sets aside \$30 million in additional Temporary Assistance for Needy Families (TANF) monies to fund incentive payments for counties to develop and implement work-oriented strategies as part of the Pay-for-Performance initiative. The program is expected to generate greater savings in 2006-07 and 2007-08, although the projected level of savings is unknown at this time.

In-Home Supportive Services (IHSS)

The Budget proposes an increase in expenditures of \$56.5 million General Fund or 4.8 percent for the IHSS program in 2005-06 above the revised 2004 Budget Act.

Reject Limiting State Participation in IHSS Wages. The Budget rejects the Governor's proposal to reduce the state's participation level for IHSS provider wages and benefits to the state's minimum wage. Reducing the state's level of participation would have reduced expenditures by \$206 million General Fund in 2005-06. Additionally, effective July 1, 2005, state participation in IHSS provider wages and health benefits increased from \$10.10 per hour to \$11.10 per hour based on the projected growth of General Fund revenues. Based on current law, the state's participation will continue to increase as General Fund revenues increase in the future.

Medi-Cal Share-of-Cost Rules. The Budget includes \$10.6 million General Fund to continue funding costs associated with applying Medi-Cal share-of-cost rules to certain IHSS recipients. The Administration is holding recipients harmless for any additional share-of-cost they may have incurred under last year's federal waiver.

Supplemental Security Income/State Supplementary Payment (SSI/SSP)

The Budget proposes \$3.5 billion General Fund for SSI/SSP in 2005-06, an increase of \$107.6 million General Fund above the revised 2004 Budget Act. Program caseload is estimated to increase to 1.2 million recipients in 2005-06, a 2.4 percent increase over the 2004-05 projected level.

Lower Grant Costs. The Budget includes \$48 million in one-time General Fund savings due to the three month delay of the January 1, 2006 federal SSI payment increase that is projected to be 2.6 percent. Additionally, the Budget includes a similar delay of the January 2007 2.1 percent SSI payment increase, generating one-time savings of \$41.6 million in 2006-07.

The 2005 Budget act also assumes additional savings of \$131.9 million General Fund in 2005-06 for suspension of the January 2006 state COLA for SSI/SSP recipients, projected to be 4.1 percent. In addition, the January 2007 state COLA, estimated to be 4.2 percent, will also be suspended, resulting in General Fund savings of \$137.2 million in 2006-07. Even with

suspension of the COLA, California's SSI/SSP payment for individuals is the second highest in the nation, while the payment for couples is the highest of all 50 states.

Child Welfare Services

The Budget includes \$2.2 billion (\$629.5 million General Fund) for Child Welfare Services (CWS).

Revised Program Improvement Plan. The Budget includes \$11.5 million General Fund to expand systematic program changes designed to facilitate compliance with state and federal performance requirements, avoid federal penalties, and improve results for children and their families.

Department of Child Support Services

The Budget assumes deferral of the 2005-06 penalty payment (\$223 million General Fund) until September 30, 2006. The Administration indicates this should be the state's final penalty payment as the department will seek certification of the single statewide automated child support system within the 2006-07 federal fiscal year (FFY). If the state is certified within the 2006-07 FFY, the state could be reimbursed up to 90 percent of the penalty amount. The Budget includes \$218 million General Fund for the 2004-05 federal penalty that will be paid in 2005-06.

Department of Aging

Health Insurance Counseling and Advocacy Project. The Budget includes an increase of the Health Insurance Counseling and Advocacy Project (HICAP) assessment fee from \$1.20 to \$1.65 per person enrolled in a Medicare health care plan. The increased fee assessment is expected to generate \$2 million in additional revenue, which will primarily be used for the training and recruitment of counselors that will assist Medicare beneficiaries and applicants in selecting and enrolling in Medicare Part D prescription drug programs.

Transportation

Proposition 42 Fully Funded. Enacted by the voters in the March 2002 election, Proposition 42 amended the State Constitution to permanently dedicate sales taxes on gasoline for transportation projects. Specifically, the Proposition requires the transfer of gasoline sales tax revenues from the General Fund to a newly created Transportation Investment Fund (TIF). The Proposition also allows the Administration and the Legislature (if two-thirds of the membership approve) to suspend the transfer of sales tax revenues in a fiscal year in which the transfer will result in a significant negative impact on government functions funded by the General Fund.

Proposition 42 transfers have been suspended for the last two years. In fiscal year 2003-04, \$868 million of the \$1.157 billion in gasoline sales tax revenues was suspended. For 2004-05, the entire \$1.243 billion is suspended. However, the Budget proposes to fully fund Proposition 42 at \$1.313 billion in 2005-06, and allocate the funds pursuant to existing law as follows:

- \$678 million to the Traffic Congestion Relief Fund
- \$127 million to the Public Transportation Account
- \$254 million to the State Transportation Investment Program
- \$254 million to cities and counties for local streets and roads

The table below displays the funding and suspension history of Proposition 42 since implementation in 2003-04.

Proposition 42 Funds		
(Dollars in millions)		
<u>Fiscal year</u>	<u>Amount to be Transferred</u>	<u>Amount Suspended</u>
2003-04	\$1,157	\$868
2004-05	1,243	1,243
2005-06	1,313	0
Total	\$3,713	\$2,111
57% of Prop. 42 Funds Have Been Suspended		

In total, \$2.1 billion or approximately 57 percent of voter-approved Proposition 42 transportation funds have been retained in the General Fund and used for non-transportation purposes.

Repayment of Transportation Loans from Tribal Gaming Bonds Delayed. Between fiscal years 2001-02 and 2004-05, the General Fund borrowed a total of \$3.667 billion from transportation, including \$1.556 billion in loans from various transportation accounts, and \$2.111 billion from the 2003-04 and 2004-05 Proposition 42 suspensions.

For 2004-05, a total of \$1.397 billion was proposed to be repaid from a variety of funding sources, authorized by both the 2004 Budget Act and AB 687 related to tribal gaming compacts. Specifically, the Budget authorizes repayment of \$183 million from a combination of General Fund and Public Transportation Account “spill-over” revenues. Also, AB 687 (Chapter 91, Statutes of 2004) proposes to repay \$1.214 billion from bond proceeds secured by tribal gaming revenues.

At the time of this analysis, the timing for sale of the bonds is uncertain due to litigation that has been filed against the State. The 2005-06 budget includes trailer legislation that would make repayment of these transportation loans contingent upon receipt of tribal gaming bonds. The Budget proposes to decrease the repayment from these bonds by \$222 million due to the absence of new compacts. This amount will either be repaid from additional compact negotiations or as part of other transportation loan repayments.

Public Transportation Account (PTA) “Spill-over” Funds. Current law contains an arcane formula that requires the General Fund to transfer sales tax revenues to the PTA under

specified conditions. This transfer is often triggered during periods of high gasoline prices and is used to fund rail and mass transit projects. The Budget retains \$380 million in “spill-over” funds in the General Fund. This proposal would, in effect, divert monies from public transit projects to the General Fund.

Culvert Inspection and Fish Passage Assessments. As part of the May Revision, Caltrans requested an augmentation of \$3.5 million to conduct assessments of water passageways and drainage, otherwise known as culverts, that cross beneath state highways. In the past, failed culverts have resulted in mudslides and collapse of large portions of roadway. The Budget approves funding for culvert inspection, but also includes language directing Caltrans to use funds, as they become available, to assess coastal streams for barriers to fish passage. The language does not specify which funds may be used, and could result in pressure to utilize transportation funds if other funds do not materialize. Caltrans estimates that completion of fish passage assessments in highest-priority areas would cost between \$6 million and \$9 million.

Environmental Enhancement and Mitigation (EEM) Program Augmentation. This program was initiated under Chapter 106, Statutes of 1989, which required a transfer of \$10 million from the State Highway Account to the EEM Fund for a period of ten years. After expiration of the statute in 1999, the Legislature continued to make the transfer in the Budget until 2002-03. No transfers occurred in 2003-04 and 2004-05 due to declining revenues to the State Highway Account. SB 77 included a legislative augmentation of \$10 million from the State Highway Account for projects such as biking and hiking trails, landscaping, and park and wildlife land acquisition. Given our transportation project backlog, we ought not be spending transportation funds on projects that do not maintain our highways or increase lane capacity. *Note: The final Budget Act deletes the \$10 million augmentation, as discussed under **Veto**es.*

No Aeronautics Account Transfer to the General Fund. Revenues for the Account are derived from an excise tax on aviation and jet fuel. These funds are typically used by publicly-owned airports to maintain and improve runways. In 2002 and 2003, approximately \$6 million and \$4.8 million, respectively, were transferred from the Aeronautics Account to the General Fund. No Aeronautics Account funds are proposed to be transferred to the General Fund in 2005-06.

Elimination of the Transportation Development Advisory Committee. The Budget and related trailer legislation eliminates the Committee effective January 1, 2006, for special fund savings of \$1,000. The Committee was created to advise Caltrans on the preparation of legislative reports, and the designation of scenic highways. The Administration indicates the advisory role can be provided more effectively on an ad hoc basis.

Redirection of Funding from Administration to Construction. SB 77 reduces Caltrans’ administrative budget by \$50 million in the current year and carries over these savings into the budget year, to be used for capital outlay programs. The savings in the current year is primarily attributable to excess salary savings from vacant positions.

High-Speed Rail. Chapter 71, Statutes of 2004 (SB 1169) delayed placing a \$9.95 billion general obligation bond measure (for a high-speed rail system) before the voters, until November 2006. The Budget includes expenditures of \$3.9 million for High-Speed Rail, of which \$2.7 million is a one-time increase for legal defense of the Environmental Impact Report,

additional environmental work, and completion of a business plan. SB 77 also included a legislative augmentation of \$650,000, half of which is from reimbursements, to fund an alignment/station study in the Southern San Joaquin Valley. Budget bill language also prohibits the expenditure of funds for completion of the business plan if the bond is delayed beyond the November 2006 election.

It's questionable whether the State ought to continue spending money on preliminary environmental and design work for a rail system that would cost as much as \$14.7 billion, assuming a 20-year term at a financing rate of 5 percent. Furthermore, if ridership revenues are insufficient to cover the operating costs, this project could end up costing taxpayers millions of dollars in annual subsidies. *Note: The final Budget Act deletes the \$650,000 augmentation, as discussed under Veto.*

Veto. The Governor vetoed a total of \$10.7 million special funds in the transportation program related to the following legislative augmentations:

- \$10 million of State Highway Account monies for the Environmental Enhancement and Mitigation Program (EEM), which funds biking and hiking trails, and landscaping.
- \$650,000 special funds for the High-Speed Rail Authority to fund an alignment/station study in Southern San Joaquin County.

Resources, Environment and Energy

Fee Increases. SB 77 and related trailer legislation proposed to increase fees in the resources and environmental protection area by as much as \$26 million. However, upon strong urging from Legislative Republicans, most of the fee increases were removed in the supplemental budget bill, SB 80. The ones that remain were either proposed by the Administration, or may be adjusted without Legislative approval. Republicans generally oppose fee increases because such policies tend to impede economic development. These and other select topics are discussed below.

- **Park Fees.** The 2004 Budget Act authorized increases for day use and camping fees in State parks. The fee revenues were to be used to repair and improve State Park water, wastewater and sewer systems to help comply with State and federal legal mandates for drinking water and waste discharge. Fees were restructured on a sliding scale based on peak demand and park popularity, and could be administratively adjusted up to a specified price range. This Administration-proposed fee increase remains within previously authorized ranges, and is anticipated to generate an additional \$6 million in revenue for 2005-06.
- **Streambed Alteration Fees.** The Department of Fish and Game is authorized to charge a permit fee for projects that impact streambeds. The department may also adjust the fee level, without new legislation, to support activities related to permit review and approval. For 2005-06, the Administration proposes to increase permit fee revenues by \$1.7 million.
- **Household Goods Carrier Fees.** The Public Utilities Commission regulates approximately 1,050 household goods carriers (movers), and mandates that these

entities meet various requirements, such as maintaining evidence of insurance, undergoing criminal background checks, etc. Due to the volume of consumer complaints in the past few years, the Administration proposes to increase fees of approximately \$521,000 on moving companies in order to fund additional enforcement staff. According to the Administration, these fees are supported by the industry.

- **Waste Discharge Permit Fees.** The State Water Resources Control Board currently charges a permit fee for discharges into state land and waterways. This fee is used to support various water monitoring and enforcement activities. SB 77 redirects \$4.5 million of federal funds from National Pollutant Discharge Elimination System (NPDES) to the surface water monitoring program and directs the Board to backfill the NPDES by increasing waste discharge permit fees. This increase does not require legislation because the Board is authorized to adjust permit fees within a certain price range. *Note: This fee increase was removed in the supplemental budget bill, SB 80.*
- **Coastal Commission Permit Fees.** The Coastal Commission currently charges a permit fee for construction or development along California's coastline. These fees are deposited into the General Fund, but are insufficient to support the permit review and approval functions. SB 77 increased permit fees by approximately \$1.7 million, such that the program is supported 50-percent from the General Fund, and 50-percent from fees. This increase does not require legislation because the Commission is authorized to adjust permit fees within a certain price range. *Note: This fee increase was removed in the supplemental budget bill, SB 80.*
- **Various Fish and Game Fees.** Recently, the Legislative Analyst's Office identified accounting irregularities within the Department of Fish and Game. Specifically, the department was redirecting fee revenues that are statutorily dedicated to restoration of a particular species, for programs that restore or protect other species. The Analyst recommended that the Department be authorized to increase various fishing and gaming licenses by \$633,000 annually in order to realign revenues with expenditures. SB 77 included budget bill language to this effect. *Note: This fee increase was removed in the supplemental budget bill, SB 80.*
- **Commercial Fish Landing Tax.** SB 77 and related trailer legislation would allow the Department of Fish and Game to adjust commercial fishing taxes based on the market value of the fish. For example, the assessment would be higher on fish such as salmon, but less on trout. This ad valorem tax could generate as much as \$6 million annually, and would be used to support enforcement of commercial fishing programs. *Note: This fee increase was removed in the supplemental budget bill SB 80 and related trailer legislation.*
- **CEQA 3158 Permit Fees.** The Department of Fish and Game charges a development permit fee for projects that are exempted from CEQA (California Environmental Quality Act) requirements. These fees are collected by the counties on behalf of the State. SB 77 and related trailer legislation would revise the fee structure, so that the fee would be based on the size and complexity of the project as well as its impact on the environment. It is estimated that this revision could increase fee revenues by as much as \$5 million annually. *Note: This fee increase was removed in the supplemental budget bill SB 80 and related trailer legislation.*

CALFED Financing Proposal. CALFED is a consortium of State and federal agencies created to address various inter-related water problems in the Bay-Delta region over the next 30 years. CALFED goals include improving water quality and wildlife habitat, increasing water supply, and reducing flood risks from levees. However, since CALFED began implementing programs and project construction in 2000, federal funding commitments have fallen short. During last year's budget subcommittee hearings, the Senate adopted a proposal that required the Bay-Delta Authority to adopt regulations establishing a CALFED user fee effective in the 2005-06 fiscal year. Upon strong urging from Republicans, the Governor agreed to withdraw all language related to a CALFED fee.

In January 2005, the Governor's budget included a framework for financing CALFED over the next 10 years that would reduce the State's contribution by assuming increased federal funds and increasing fees on local water agencies and other water users. However, due to stakeholder opposition, the May Revision CALFED finance plan was modified from a 10 year plan, to a 2-year interim plan to allow the Administration time to work with water user groups on funding options. The proposal also includes "reimbursements" of up to \$30 million annually for the Ecosystem Restoration Program, and \$300,000 for an independent review and evaluation of CALFED. Also, there is no mention of a statewide water tax.

SB 77 approves \$146 million of the Governor's proposed \$272 million plan for CALFED and includes funding for select projects that meet the approval of the Senate and Assembly budget subcommittees. Overall, the funding tends to favor habitat restoration over water quality and supply. SB 77 also rejects the \$30 million "reimbursement" from water user groups on the basis that it is unclear how the funds would be used.

The Administration has been working to partially restore some of CALFED cuts. Water user groups have also formed a coalition to support a handful of critical CALFED projects totaling \$55.8 million. These projects are included in the Administration's restoration proposal. Any additional funds that are approved for CALFED would be appropriated in a separate supplemental budget bill.

Although the need for a CALFED consortium and its program effectiveness remains questionable, the Administration has taken a more modest and methodical approach to funding CALFED since its January proposal. CALFED would be more supportable for Republicans if it were to include the following:

- Restoration of funding for the critical CALFED projects identified by the water user coalition – also supported by the Administration.
- Inclusion of budget or trailer language specifying how the \$30 million reimbursements would be used. This is to ensure that funds would be directed towards restoration projects that would improve water supply and reliability.
- Additional assurances to protect water users from future water loss or financial outlays.
- A commitment from the Administration to scale-back the CALFED program to mitigate the need for future taxes and fees.

Note: At the time of this analysis, the supplemental CALFED bill is still being negotiated and will be handled as legislation separate from the Budget and trailer legislation.

Levee Maintenance. Last year, a levee break in the Jones Tract portion of the San Joaquin delta caused millions of dollars in damages. The State responded with financial assistance for levee repair and debris removal. However, as the result of a recent court ruling on the *Paterno v. State of California* case, the State's liability could increase substantially for future levee failures. The Budget includes \$9.7 million General Fund and 27 positions. This funding is the first installment of a 3-year plan to improve and maintain the Sacramento and San Joaquin Valley flood system, and develop and implement a more comprehensive flood protection plan. The Administration also indicates that they are evaluating alternatives for funding flood protection activities, including creation of a special district with the authority to impose fees, and exploring possibilities for mandatory flood insurance for residents living near flood control levees.

Paterno Settlement. A California Court of Appeals recently found the State financially responsible for a 1986 levee break in Yuba County that flooded 7,000 acres of land. Initially, the Governor's budget proposed to fund the settlement amount of \$464 million with a settlement bond. However, due to legal barriers, the May Revision proposes to fund this amount through an agreement with Merrill-Lynch, wherein the plaintiffs would be paid \$464 million in a lump sum and the State would pay Merrill-Lynch the principal plus variable interest based on the London Interbank Offering Rate (LIBOR). The current rate is approximately 4.29 percent. The Budget approves funding for the first-year installment.

All-American and Coachella Canals. Consistent with the Quantification Settlement Agreement (QSA), SB 77 proposes \$59.1 million General Fund for the lining of the All-American and Coachella canals. The QSA is an agreement between various federal, state, and local agencies to reduce California's use of the Colorado River. Lining of the canals is anticipated to reduce the amount of water that is absorbed into the ground, thereby increasing the supply of water by about 100,000 acre feet.

Department of Forestry and Fire Protection (CDF). The CDF's primary duties include oversight of the State's forests and fire suppression on the State's forestlands and State responsibility areas, also known as SRA's. For the 2005-06 fiscal year, SB 77 proposes funding for fire suppression activities as follows:

- \$25 million for emergency firefighting costs;
- \$10.8 million for the replacement of 40 fire engines and other fire-fighting equipment; and
- \$9 million for firefighters to provide year-round fire suppression coverage in the counties of Riverside, San Bernardino, and San Diego.

SB 77 rejects the Governor's proposal for one-time funding of \$5 million (General Fund) for replacement of 19 fire engines, but restores an unallocated General Fund reduction of \$6.7 million for staffing and operating expenses.

River Parkways. The Budget proposes \$7,850,000 from Proposition 40 bond funds, and \$30,500,000 from Proposition 50 bond funds to provide grants to public and nonprofit entities for river parkway projects. Specifically, these funds would be used for the acquisition and development of river parkways.

Williamson Act. The Budget maintains subvention funding for the Williamson Act at approximately \$40 million, and includes a legislative augmentation of \$345,000 for 3 positions to increase enforcement of Williamson Act contracts. *Note: The final Budget Act deletes the \$345,000 augmentation, as discussed under Veto.*

Sierra Nevada Conservancy. The Budget proposes \$3.6 million and 13.5 positions to support the newly created Sierra Nevada Conservancy, and \$11.7 million in Proposition 50 bond for grants to public and nonprofit entities for the acquisition of land and water rights that would protect water quality in the region.

Elimination of Interagency Aquatic Invasive Species Council. The Budget and related trailer legislation eliminates the Council because it was never formed and the Department of Fish and Game already performs the Council's mandated activities.

Veto. The Governor vetoed \$17.5 million General Fund and \$28.3 million special funds from legislative augmentation in the resources, environmental protection and energy programs. Select veto items are discussed below:

- \$500,000 special fund for Cal-EPA to monitor and study changes in climate.
- \$5 million General Fund for the Department of Fish and Game related to the hiring of 40 additional game wardens.
- \$1 million General Fund for the Department of Fish and Game related to the hiring of 7 additional staff to restore trout habitat and population.
- \$4 million veto of an \$8 million legislative augmentation from Tidelands Oil Revenue for the Department of Fish and Game to restore salmon and steelhead habitat and population.
- \$3 million from Tidelands Oil Revenue for the Department of Fish and Game's fish hatchery activities.
- \$9 million Tidelands Oil Revenue for the Department of Parks and Recreation deferred maintenance activities.
- \$950,000 General Fund for the Coastal Commission to address workload related to natural gas reviews and offers-to-dedicate public access.
- \$345,000 special funds for the Department of Conservation to increase enforcement of Williamson Act contracts.
- \$1 million for the Public Utilities Commission for staff to review telecommunications mergers.
- \$4 million transfer of rate-payer surcharge revenues to the General Fund.

The Governor sustained the following legislative augmentations:

- \$1.7 million General Fund for the Department of Fish and Game related to the hiring of 15 additional staff to review timber harvest plans.

- \$12.5 million legislative augmentation for the Air Resources Board to replace pre-1977 school buses.
- \$10 million redirection of funds in the Carl Moyer Program to retrofit diesel school buses.

Public Safety and Judiciary

Judicial Branch (State Trial Court Funding). Trial Court Funding is displayed as a new program within the Judicial Branch in the Budget and \$2.5 billion (\$1.45 billion General Fund) is provided for support of the trial courts. The Budget includes an increase of \$130.7 million General Fund to reflect the first budget adjustment pursuant to a statutory growth factor formula based upon the State Appropriations Limit established by 2004 Budget Trailer Legislation. The amount reflects a \$4.1 million reduction taken by the Budget Conference Committee which appears reasonable.

Additionally, the Budget includes an increase of \$92.6 million General Fund for various increased costs related to staff benefits, court security and county services, proposed in the Governor's Budget, and fully restores a one-time reduction of \$60.5 million General Fund.

However, the Governor vetoed \$57.5 million as a one-time base reduction of a portion of the General Fund (\$1.45 billion) transfer to the Trial Court Trust Fund. This veto will require the courts use the Trial Court Trust Fund in lieu of General Fund thus decreasing the reserve from \$67.5 million to \$10 million. This action increases the General Fund reserve. At this time, it is unclear and unknown what impacts, if any, this might have on court or administrative operations and/or cash-flow.

The Budget includes \$308 million General Fund for support of the Judicial Branch (Supreme Court, Courts of Appeal, Judicial Council, Judicial Branch Facility Program, and the Habeas Corpus Resource Center). Additionally, \$34.1 million General Fund is provided for Judicial Administration Efficiency and Modernization.

The Budget reappropriates \$75,000 for the property acquisition phase of the Fourth Appellate District Courthouse project (Santa Ana) and reverts \$2.2 million of the original appropriation to the General Fund.

Uniform Civil Filing Fee. Trailer legislation establishes a uniform civil fee (UCF) structure to streamline and simplify the civil fees by rolling the current varied surcharges and add-on fees into one filing fee. The same fees will be charged for the same services (first paper filings, probate, small claims, and other miscellaneous fees) across all 58 counties. The various other existing fees being replaced would sunset and the UCF would become operable on January 1, 2006. Additionally, the measure would continue the court security fees until December 31, 2005.

The proposed fee changes result in a full-year increase in revenue of \$45.4 million to be used for specified court programs. \$16 million of the increase (\$8 million in 2005-06) would be offset in 2006-07 and beyond by the court security fee when it sunsets, thus resulting in a full-year net revenue increase of \$29.5 million.

According to the Administrative Office of the Courts, the full-year additional **net** revenue increase of \$29.5 million would benefit the Facilities Program (\$9.9 million), Micrographics - Information Technology (\$10.8 million), and the Equal Access Fund (\$5 million). The remaining increase of \$3.7 million would be retained as a set-aside to fund increases in the Law Library, Dispute Resolution, and Children's Waiting Room fees.

The Governor vetoed \$9.8 million from the General Fund transfer item as a result of the establishment of the UCF that would bring in increased revenue of \$14.75 million in 2005-06 and provides for a subsequent appropriation of a like amount. The courts will be able to utilize \$4.95 million for the court facilities program. However, it is unclear if the courts will be required to make-up the \$9.8 million by redirecting other General Funds or directly from the Trial Court Trust Fund reserve to fund Information Technology, Micrographics and/or Equal Access funding obligations. The \$9.8 million reduction to the General Fund transfer increases the General Fund reserve.

Undesignated Fees/Civil Assessment Fee Increase. Trailer legislation incrementally reduces and eventually eliminates over a 4-year period the counties' obligation to pay to the courts \$31 million annually pursuant to Government Code 68085.5, also referred to as undesignated fees. Counties would be obligated to pay \$20 million in 2005-06, \$15 million in 2006-07, \$10 million in 2007-08, \$5 million in 2008-09, and \$0 in subsequent years.

The trailer legislation also increases the civil assessment maximum to \$300 (now at \$250) which would generate \$7.5 million of additional fee revenue. The civil assessment is only imposed as a penalty to a "defendant who fails, after notice and without good cause, to appear in court for any proceeding authorized by law or who fails to pay all or any portion of a fine ordered by the court."

The measure creates a revenue neutral proposal between the counties and courts, but relies on a \$7.5 million fee increase. It provides various safeguards holding the state General Fund harmless including that no state funds shall be appropriated to the courts to mitigate any revenue shortfalls, and provides that nothing in the section shall shift the responsibility for court funding from the counties to the state.

California Law Revision Commission. The Budget provides \$685,000 General Fund for the continued operation of the commission which includes a legislative augmentation of \$150,000 in order to reduce current workload backlog from 9.8 years to 2.5 years.

Department of Justice. The Budget includes \$15.9 million from the DNA Identification Fund and \$2.0 million General Fund to address workload resulting from the expanded collections of DNA, palm prints and thumbprints pursuant to Proposition 69.

The Budget also includes several additional General Fund augmentations which include:

- \$4.2 million and 29.5 positions to handle increased medical malpractice/deliberate indifference cases received from the Department of Corrections and Rehabilitation.
- \$4 million and 8.0 positions in order to begin replacement of five automated database systems. The five databases provide statewide support for Wanted Persons, Stolen

Vehicles, Supervised Release File, Firearms Eligibility Applicants, and Domestic Violence Restraining Orders.

- \$3.3 million and 23.0 positions to handle increased state and federal *habeas corpus* litigation.
- \$2.5 million for a one-time purchase of laboratory equipment for the Bureau of Forensic Services to improve current capabilities and replace outdated, un-repairable equipment used by the lab system.
- \$1.8 million for the Renovation of the Violent Crime Information Network (VCIN).
- \$1.7 million and 12.4 positions for Bureau of Forensic Services workload.
- \$1.2 million and 8.2 positions to defend individual and class-action suits (1) challenging the conditions of confinement for sexually violent predators (SVPs); and (2) involving the release of SVPs at the conclusion of their hospital treatment.

Department of Corrections and Rehabilitation. The Budget provides \$7.3 billion General Fund for support, local assistance, capital outlay for the Department of Corrections and Rehabilitation (DCR).

The Governor's Reorganization Plan #1 and Chapter 10, Statutes of 2005 (SB 737-Romero, et. al.) reorganizes and consolidates the Youth and Adult Correctional Agency (YACA), Department of Corrections, Department of the Youth Authority, Board of Corrections, Commission on Correctional Peace Officers' Standards and Training, Board of Prison Terms and the Youth Authority Board into the DCR.

The Administration initially requested \$4.1 million General Fund to begin comprehensive statewide juvenile justice reform. Instead the Budget Conference Committee included \$400,000 General Fund and authorized a redirection of \$850,000 for this purpose, which we believe is reasonable.

The Budget restores \$51.2 million of the \$95.3 million reduction of funding for inmate and parole programs proposed in the Governor's Budget. The reduction of \$44.1 million will be taken from the various inmate and parole programs which have been scaled back as a result of a change in policy or implementation problems or delays.

The Budget includes \$365.6 million General Fund to address inmate population growth estimates as well as a reversal of savings assumed for parole accountability programs (\$58.1 million).

The Budget provides \$7.5 million General Fund (half of the Administration's request) to be set-aside and available to DCR to enhance inmate and parole programs that have been determined to be effective and evidence-based. The full year cost would be \$15 million. This funding will only be available pending a report to the Legislature.

The Budget reflects the rejection of the Administration's proposal to establish three new mental health facilities (Chino, San Luis Obispo, and Sacramento) that would have housed approximately 6,000 inmates with a total construction cost of \$1.4 billion. This major policy issue is better vetted through the normal legislative process.

Some of the additional General Fund augmentations provided in the Budget for DCR's Adult Division include:

- \$271.5 million related to previously negotiated compensation increases for DCR Adult Division employees.
- \$35 million to reduce salary savings rates in order to fund and fill critically needed posted positions.
- \$34.8 million for operating expenses and equipment price increase.
- \$29.1 million to increase the number of Basic Correctional Officer Academy cadets from 640 to 1,920 annually.
- \$13.3 million and 59.6 positions to implement improvements in the dental program in order to avert a class action lawsuit which represents a \$4 million reduction from the Administration's proposal.
- \$5.8 million and 46.0 positions to address personnel and physical plant security and safety issues at California Institution for Men in Chino. This is in response to the officer stabbing death that occurred at the institution.
- \$5.2 million and 59.6 personnel years in order to comply with a court order issued under the *Coleman* lawsuit. These funds will be used to implement the revised guidelines for the mental health service delivery system in the Administrative Segregation Unit and Security Housing Unit at the California State Prison-Corcoran and to fund recruitment and retention pay differentials for mental health positions at 12 institutions.

Some General Fund augmentations provided in the Budget for DCR's Juvenile Division include:

- \$16.7 million related to previously negotiated compensation increases for DCR Juvenile Division employees.
- \$10.1 million to reflect the need to adjust downward reimbursements to actual levels and backfill with General Fund.
- \$6.7 million to implement disability, sex offender treatment, and mental health remedial plans required by the *Farrell v. Allen* lawsuit.
- \$1.5 million to fund a training needs assessment, develop curricula and provide additional training.

Corrections Standards Authority (CSA). CSA was formerly known as the Board of Corrections. The Budget includes \$201.4 million General Fund for county youth probation programs. Additionally, trailer legislation transfers responsibility to administer these funds to the Board from the Department of Special Services and specifies county funding allocation. The Administration had initially proposed that federal Temporary Assistance for Needy Families funds be used to support these programs. Therefore, this will result in an ongoing General Fund funding pressure.

Office of the Inspector General. The Budget includes \$15.4 million General Fund for support of the Office. This includes an augmentation of \$3.6 million General Fund and 24 positions as the result of developing a workload budget consistent with the legislative

requirements of Chapter 733, Statutes of 2004 (SB 1342-Speier). An additional augmentation of \$3.0 million General Fund and 19 positions are provided to conduct the warden selection and institutional audit processes as required pursuant to Chapter 10, Statutes of 2005 (SB 737-Romero, et. al.).

General Government

Office of Emergency Services/Homeland Security. The Budget reflects rejection of the Administration's proposal to establish a separate independent Office of Homeland Security. The Administration is currently sponsoring separate legislation to establish the office (SB 1015 - Senator Poochigian and Assemblymembers Parra and La Suer).

The Budget increases federal fund authority by \$146.4 million for homeland security activities. \$117.1 million will be allocated to local agencies (grantees) for homeland security activities and \$29.3 million, to fund 21 additional positions, of which \$22 million will be provided to other state agencies such as the Department of the Military. Trailer legislation requires the Director of Homeland Security and the Department of Health Services to report on federal homeland security and bioterrorism funding expenditures.

The Budget provides \$35 million General Fund (\$32.8 million local assistance and \$2.2 million state operations) for the estimated costs of response and recovery efforts related to federally declared disasters in Southern California caused by flooding and mudslides, and \$5 million General Fund to purchase new fire engines for mutual aid support.

Tribal Gaming Impact Mitigation/California Gambling Control Commission. The Governor vetoed a legislatively proposed one-time funding augmentation of \$20 million from the Indian Gaming Special Distribution Fund (SDF) to increase grants to local governments to mitigate the impacts of tribal gaming. The Governor indicated that two annual reports that detail specific previously funded projects were not submitted by local governments, thus he could not justify the augmentation. This will leave an \$88.7 million SDF fund balance at the end of 2005-06.

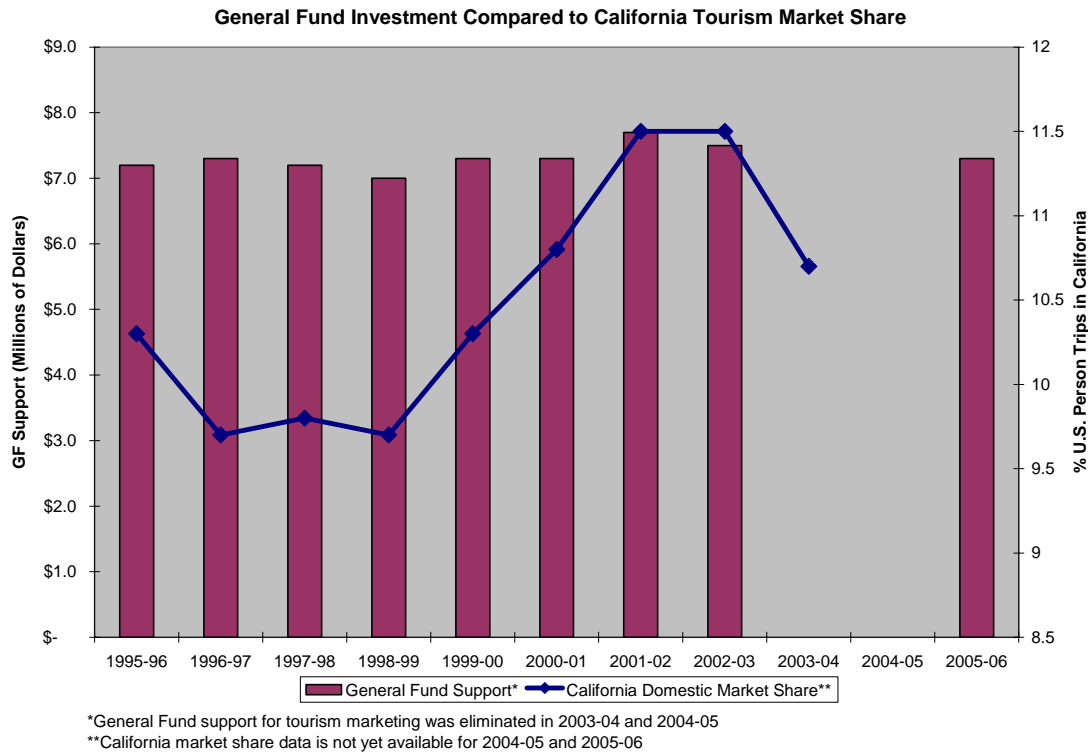
The Budget Conference Committee rejected the Administration's proposal to provide additional resources to the Gambling Control Commission for Tribal-State Gaming Compact Workload.

Office of Administrative Law. The Budget includes an increase of \$224,000 General Fund and 2.0 positions, for a total General Fund budget of \$2.4 million, to determine whether particular state rules, guidelines, and other documents, are in fact regulations subject to the regulatory review process, and to enforce provisions of the current law that restrict state agencies from issuing, utilizing, or enforcing "underground regulations."

Department of the Military. The Budget includes an augmentation of \$5.2 million (\$3 million General Fund and \$2.2 million Armory Fund) to reduce the backlog of deferred maintenance and repairs.

Tourism - The Budget includes the Administration's proposal to provide \$7.3 million General Fund to the California Travel and Tourism Commission (CCTC) for statewide tourism marketing. After eliminating this funding the past two years, this augmentation re-establishes

state support for tourism marketing. The CTTC has made the argument that a recent drop in the California market share of domestic travel is related to the elimination of General Fund subsidies of tourism marketing in 2003-04. However, using historical data dating back to 1995-96, in which tourism funding was stable for much of the 1990s, it is somewhat difficult to discern a relationship between the two factors. Indeed, the relative health of the economy may be a more important influence on tourism in California than state-funded marketing efforts.



Unallocated Reduction – The Budget adds a new Control Section 4.05 which allows the Department of Finance, after 30 day notice to the Legislature, to reduce General Fund items of appropriation by \$100 million General Fund. This reduction is in addition to the \$150 million statewide reduction that has been assigned by department, but in many cases remains unallocated to individual programs.

Ready Return. The Budget allows the Franchise Tax Board (FTB) to spend up to \$215,000 to continue a controversial pilot program initiated in current year that sends pre-filled out tax forms to single tax-filers with no dependants. This level of funding could allow the FTB to select over 50,000 possible participants.

Ban on Deficiency Funding for Special Elections. The Budget prohibits the Department of Finance from seeking deficiency funding or supplemental appropriations for any costs associated with a statewide special election.

The Governor made the following significant vetoes in the General Government area:

- **\$20 million legislative augmentation for the Indian Gaming Special Distribution Fund (SDF)** that would have provided additional grant funds to mitigate the impacts

of tribal gaming on local government agencies. This will leave an \$88.7 million SDF fund balance at the end of 2005-06 (see above).

- **\$6.2 million and 114 personnel years from the Office of State Publishing (OSP).** The OSP has incurred \$14.3 million in losses over the last ten years, including a \$5.5 million loss in 2003-04 (a 27 percent revenue decrease). With this veto, “core” OSP services to the Legislature and other state agency clients will be preserved.
- **\$3 million and 30.4 personnel years at the Department of Industrial Relations** to expand enforcement efforts by the Labor Commissioner and the Bureau of Field Enforcement.
- **\$2.4 million in legislative augmentations at the Bureau of State Audits (BSA) and the Department of Finance (DOF) for additional auditors.** The Legislature rejected the Governor’s proposal for a new Office of State Inspector General and, instead, augmented the budgets of the BSA and the DOF for additional auditing activities. However, the Governor indicates that this legislative “compromise” does not address the identified broader need for criminal investigation and prosecution of state governmental activities. The Administration plans to re-submit a proposal for an Office of the Inspector General next year.
- **\$2.4 million General Fund in legislative augmentations for additional auditor and attorney positions** at the Franchise Tax Board, the Board of Equalization, and the Employment Development Department.
- **\$2 million for the Secretary for Business, Transportation and Housing** to fund AB 721 (Nunez), which would provide loans to chrome plating businesses.
- **\$283,000 and 3.0 positions for the Bureau of Security and Investigative Services.** The Administration indicates, “This augmentation is not based on a justified programmatic need, but rather was made because there is a growing fund reserve in the Private Security Services Fund. The growing fund balance reflects a need for the Bureau to reduce fees paid by registrants and is not a reason to increase staffing.”

Department of Housing and Community Development

Homelessness Initiative. The Budget proposes to redirect \$35 million in unused funds from existing housing bonds, and \$10 million from the California Housing Finance Agency, along with \$750,000 from Proposition 63, the Mental Health Services Act, to create 400-500 units of permanent housing with services for chronic mentally ill populations.

Retirement and Employee Compensation

Augmentation for Employee Compensation. The Budget includes funding for salary increases required under current contractual obligations for a number of bargaining units, including highway patrol, correctional peace officers, firefighters, engineers, crafts and maintenance, and psychiatric technicians. Overall, the Budget includes \$355 million (\$162.8 million General Fund) for salary increases and dental and vision premium increases.

Section 3.60 CalPERS Rate Adjustments. The Budget includes savings of \$152.7 million General Fund resulting from the adoption of a new policy for calculating the actuarial value of

assets. The new policy includes spreading the market value asset gains and losses over 15 years as opposed to the current 3 years, and changing the corridor limits for the actuarial value of assets from 90 percent—110 percent of market value to 80 percent—120 percent of market value.

Pension and Employee Compensation Reform. The Budget reflects a reform to the state's employee retirement system estimated to save approximately \$37 million (\$18.2 million General Fund) in 2005-06. State miscellaneous and industrial retirement category employees will be permitted to choose whether or not to continue membership in the Public Employees Retirement System (PERS). Employees who elect to opt out of PERS will be provided additional compensation equal to one-half the employer's normal cost of retirement.

The Budget also includes savings of \$39.5 million (\$21.7 million General Fund) from anticipated reductions in employee compensation resulting from negotiations with collective bargaining units whose contracts have expired. The Budget assumes savings from reducing the number of state holidays from 14 to 12 and from eliminating leave in the calculation of time worked when computing overtime. It is unknown whether or not these savings are achievable in 2005-06 as they are dependent upon future negotiations, the outcomes of which are unknown at this time.

Pension Obligation Bond. The Budget continues to assume sale of the Pension Obligation Bond (POB) in 2005-06, generating General Fund relief of \$525 million.

State Teachers' Retirement System. The Budget provides \$30.6 million General Fund in 2005-06 for the state's statutory obligation in funding the 1990 level of benefits for State Teachers' Retirement System (STRS). The June 30, 2003 valuation of the STRS Defined Benefit program identified a \$118 million liability in the pre-1990 benefit level. The state made a \$92 million General Fund contribution in 2004-05.

Local Government

Full Vehicle License Fee Gap Loan Repayment. The Budget includes full repayment of the entire \$1.2 billion due to repay cities and counties the vehicle license fees (VLF) that they did not receive in 2003-04 due to the suspension of the VLF offset. Payment of the \$1.2 billion VLF gap loan is not required until 2006-07, but prepaying it in 2005-06 will relieve state budget pressure in 2006-07 and provide much-needed revenues to local governments earlier.

Mandates. The Budget funds \$119.4 million in General Fund for non-education mandate costs in 2004-05 and estimated 2005-06 costs (not including the AB 3632 mandates). After many years of legally deferring the payment of state mandates, the passage of Proposition 1A last November changed the law to require that if a mandate is not fully funded in the subsequent State budget, the mandate would be suspended. Although this \$119.4 million in funding is a significant first step toward paying cities and counties for state mandates, Proposition 1A also required that the existing mandate debt would be repaid to local governments over five years, beginning in 2006. A budget trailer bill extends the repayment period of the outstanding mandate claims (approximately \$1.2 billion) due from the state to local governments from 5 years to 15 years.

Rural Sheriff Department Funding. The Budget includes \$18.5 million from the General Fund for allocation to county sheriffs' departments to enhance law enforcement efforts in the counties specified under current statute.

Property Tax Administration Grant Suspension. The Budget eliminates \$60 million in funding for property tax administration grants to counties for 2005-06. In addition, a separate trailer bill prohibits the Department of Finance from proposing any funding for this program in the 2006-07 Governor's Budget.

Citizens' Option for Public Safety (COPS)/Juvenile Justice Crime Prevention Act (JJCPA). The Budget adopts the Administration's proposal to fund the Juvenile Justice Crime Prevention program at \$26.1 million for one year to realign and adjust allocation timing to better match expenditures. This results in a one-time General Fund savings of \$73.9 million. Currently, JJCPA program funding is appropriated one year in advance. Provisional language provides that the Citizens' Option for Public Safety program would receive \$100 million in 2005-06.

Rural Crime Prevention Program. The Budget provides \$2.1 million General Fund for the Rural Crime Prevention Program thereby restoring funding proposed for reduction in the Governor's Budget to the 2004-05 level of \$3.3 million and provides an additional \$300,000 to Monterey County as a planning grant consistent with the Central Coast Rural Crime Prevention Program established pursuant to Chapter 18, Statutes of 2003 (SB 44 – Denham, McPherson, Maldonado et al.).

Scott Peterson Homicide Trial Reimbursement. Trailer legislation provides that funds appropriated from Budget Act Item 8180-101-0001, local assistance, Payments to Counties for Costs of Homicide Trials, shall be available for 100 percent of any extraordinary costs incurred by the County of Stanislaus related to the Scott Peterson homicide trial. The Budget funds this Item at \$4.3 million, General Fund. This legislation also prohibits reimbursement from this Item for Superior court costs which are funded via state Trial Court funding.

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